South Carolina Law Review

Volume 19 | Issue 5 Article 2

1967

Scope and Coverage of Article 9

SCOPE AND COVERAGE OF ARTICLE 9

I. Scope of Article 9

The overall purpose of Article 9 of the Uniform Commercial Code is to provide a simplified set of rules governing chattel security which also meet the needs of today's commercial society.[1] In as much as the purpose of Article 9 relates to chattel security, its scope and coverage is limited to chattel financing.

Article 9 of the Code is divided into four primary areas. First, it deals with the security transaction and the creation of the security interest. Basically, this comprehends an interest in personal property or fixtures which secures payment or performance of an obligation. Once the security interest is created, Article 9 shifts its attention to the perfection of this security interest against the claims of third parties. The natural progression after the perfection of the security interest is the determination of which party has priority in the security. Finally, the fourth area regulated by Article 9 is the liquidation of the collateral when the debtor is in default.

Because Article 9 coverage is limited to the general area of chattel financing, it is important to outline the particular types of transactions which are within the scope of the Article. Section 9-102 of the Code outlines the "Policy and Scope of Article":

> (1) Except as otherwise provided in Section 9-103 on multiple state transactions and in Section 9-104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state
>
> > (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also
> >
> > (b) to any sale of accounts, contract rights or chattel paper.
>
> (2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, con-

1. S.C. Code Ann. § 10.1-102(2) (1966).

ditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in Section 9-310.

(3) The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply.[2]

The broad sweep of this coverage is intended to extend to all consensual security interests in personal property and fixtures unless the transaction is excluded by the application of South Carolina Code Sections 10.9-103 and 10.9-104. To appreciate the coverage of Article 9 it is necessary to examine the exclusions.

Article 9 coverage does not apply to mortgages or liens on real property.[3] Furthermore, it does not apply to "security interests subject to any statute of the United States . . . to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property."[4] However, as will be discussed later, this provision is to be distinguished from the provision of section 10.9-302 of the Code which discusses the effect of a national filing system.

Article 9 does not apply to landlord's liens, the transfer of a claim for wages, salary or other types of compensation of an employee, to an equipment trust covering railway rolling stock, to a transfer of an interest or claim in or under any policy of insurance or to any right of set-off.[5]

Although Article 9 does classify the sale of accounts, contract rights or chattel paper as security transactions,[6] it does not apply if the sale of accounts, contract rights or chattel paper is part of "a sale of the business out of which they arose, or as an assignment of accounts, contract rights or chattel paper which is for the purpose of collection only, or a transfer of a contract right to an assignee who is also to do the performance under the contract."[7] These particular transactions are essentially transfers which have nothing to do with chattel financing.

2. *Id.* § 10.9-102.
3. *Id.* § 10.9-104(j).
4. *Id.* § 10.9-104(a).
5. *Id.* § 10.9-104.
6. *Id.* § 10.9-102.
7. *Id.* § 10.9-104(f).

Article 9 does not cover the transfer of a tort claim, any deposit, savings, passbook or like account in a bank, savings and loan institution, credit union or other like organization.[8]

The general application of Article 9 is easily understood by a reading of the Code sections. However, there are several areas in which there are serious questions as to Article 9 coverage. The Code does not make it clear whether subordination agreements, suretyships, or some leasing agreements which have an option to purchase are security transactions which require an application of the provisions of Article 9. Since these areas of commercial financing represent a vast quantity of transactions and large monetary investments, a more thorough analysis of their place within the provisions of Article 9 is required.

II. QUESTIONABLE COVERAGE UNDER ARTICLE 9

A. *Subordination Agreements*

A subordination agreement is a contract which gives one creditor, known as the senior creditor, priority over another creditor, known as the junior creditor or subordinator, of a common debtor.[9] The use of subordination agreements is recognized and approved by the Uniform Commercial Code.[10] However, the drafters of the Code did not envision the problems arising from the use of these agreements. No recognition *per se* was given to the legal effect of such agreements or to the rights and duties created by such an agreement.[11]

The basic problem surrounding the use of subordination agreements is whether the typical subordination agreement creates a "security interest" in the junior creditor. Section 10.1-201 (37) of the South Carolina Code, defines a security interest as "an interest in personal property . . . which secures performance of an obligation."[12] If it is the intended result that the transaction create a "security interest", then it is essential for the senior creditor to perfect his "security interest" to be entitled to Article 9 protections.[13]

There are conflicting opinions as to whether subordination agreements do in fact create a "security interest." One argument

8. *Id.* § 10.9-104(k).
9. C. FUNK, BANKS AND THE U.C.C. 82 (1953).
10. S.C. CODE ANN. § 10.9-316 (1966).
11. 2 G. GILMORE, SECURITY INTEREST IN PERSONAL PROPERTY, 994 (1965).
12. S.C. CODE ANN. § 10.1-201 (37) (1966).
13. 2 G. GILMORE, *supra* note 11, at 996.

that a subordination agreement creates a "security interest" in the junior creditor is that the junior creditor has certain rights and privileges against the debtor which come into existence when the debt is created. By subordinating these rights, the junior creditor is in effect surrendering some of the rights to the senior creditor. The effect of this surrender is that it gives the senior creditor more security than he would enjoy if he lacked priority.[14] This argument assumes that there was an intention between the parties to create a security interest.[15] However, it may be contended that even if the creation of a security interest is not clearly articulated by the parties, the security interest may be implied from the facts and the applicable law.[16]

There are several arguments to support the position that a subordination agreement does not create a "security interest" and, therefore, requires no filing for perfection under the Code. One of the positions taken is that a "security interest" is created only where the parties intend to create such by a contractual agreement.[17] The argument is that the collateral provides the security and the subordination agreement only provides for priority.

Another argument is that the creditors do not look to their transaction as determining the rights in the collateral after default.[18] It has been said that the essence of the security transaction is the determination of the rights in the collateral after default.[19] However, this argument assumes that the subordination agreement ignores the collateral as an essential part of the subordination transaction. A subordination agreement could subordinate rights in collateral and, therefore, come well within the "essence of the security transaction."

A third argument to support the contention that a subordination agreement is not a security transaction is that the typical subordination agreement does not "fit into the mechanics" of Article 9.[20] There are no provisions in the Code as to what type of agreement would be filed, who would file the agreement, and

14. 2 COOGAN, HOGAN, AND VAGTS, SECURED TRANSACTIONS UNDER THE U.C.C. 2368 (1966) (hereinafter cited as COOGAN).

15. S.C. CODE ANN. §§ 10.9-102, 10.9-104 (1966).

16. COOGAN, *supra* note 14, at 2368.

17. *Id.* at 2359.

18. *Id.* at 2362.

19. S.C. CODE ANN. § 10.9-501 (1966); UNIFORM COMMERCIAL CODE § 9-501, Comment 1.

20. COOGAN, *supra* note 14, at 2363.

against whom the agreement would be filed. Furthermore, the Code makes no provision for the subordinated party when the common debtor or the junior creditor is in default.

The validity of this argument assumes that the Code drafters were cognizant of the problem and took affirmative steps to resolve it. Since Article 9 makes no attempt to answer the questions raised by subordination agreements and in fact fails to make mention of their legal significance, other than to approve their use, this argument may very well have validity.

In the final analysis, the question of whether or not the subordination agreement creates a security interest is a question for judicial determination.[21] At present, no court applying the Uniform Commercial Code to this problem has ruled on the question. However, in *Pioneer-Cafeteria Foods, Limited v. Mack*,[22] the court, by implication, found that while a subordination agreement determines priority between the contracting parties,[23] it does not affect the rights of other creditors where the other creditors have no notice of the agreement.[24] In that case the senior creditor had secured a subordination agreement from the junior creditor in order to have priority over the collateral of the common debtor. Both the junior creditor and the common debtor became insolvent and went into bankruptcy. The court found that as a matter of priority, the senior creditor's rights were superior to those of the junior creditor because of the subordination agreement. The junior creditor's trustee in bankruptcy had been awarded a creditor's share in the assets of the common debtor and the senior creditor was attempting to reach this share on the theory that he had a priority on the share because of the subordination agreement. However, since the other creditors had no notice of the agreement, the senior creditor took as a general creditor of the junior creditor.[25]

The uncertainty in this area has caused the Permanent Editorial Board of the Uniform Commercial Code to propose an amendment to the Code to remove the possibility that the rights of the senior creditor against the subordinator might be held as a "security interest" governed by Article 9 of the Code:

21. 2 G. GILMORE, *supra* note 11, at 995.
22. 340 F.2d 719 (6th Cir. 1965).
23. *Id.* at 723.
24. *Id.*
25. *Id.*

Subordinated Obligations:

> An obligation may be issued as subordinated to payment of another obligation of the person obligated, or a creditor may subordinate his right to payment of an obligation by agreement with either the person obligated or another creditor of the person obligated. Such a subordination does not create a security interest as against either the common debtor or a subordinated creditor. This section shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it.[26]

There are several practical aspects of this problem. If the amendment to the Code is not adopted and if the courts interpret subordination agreements as creating "security interests" between the junior and senior creditors then the perfection requirements of Article 9 will be applicable. In this regard, the junior creditor may object to the senior creditor's filing a financial statement since the junior creditor is not an actual debtor of the senior creditor. The junior creditor may fear that this will cast a reflection on his own financial condition.[27]

Secondly, this problem generally becomes important in the situation where both the common debtor and the junior creditor become bankrupt, or at least where the creditors of the junior creditor are claiming an interest in the debt of the common debtor. In this situation the contest is between the senior creditor and the junior creditor's trustee in bankruptcy over the assets of the common debtor.[28]

Another practical aspect of the "security interest" problem is that in many of the areas where subordination agreements are commonly used, Article 9 is not applicable. For example, if the creditor's claim is for deferred salary, Article 9 protections clearly do not apply.[29] If the subordinated debt is represented by notes or debentures, the security interest must be perfected by obtaining possession of the "instrument."[30] Many subordination agreements are creatures of equity and are clearly outside the scope of Article 9.[31]

26. Proposed Uniform Amendments Uniform Commercial Code § 1-209 (1962).
27. FUNK, *supra* note 9, at 83.
28. *Id.*
29. S.C. CODE ANN. § 10.9-104(d) (1966).
30. *Id.* §§ 10.9-304(1), 10.9-305.
31. COOGAN, *supra* note 14, at 2359.

A fourth aspect of the problem is that many financiers feel that the likelihood of a fellow creditor of the common debtor becoming insolvent is small. They feel that a contractual priority between the creditors is sufficient protection.[32]

The need for clarification is evident. The Code's treatment of future advances and after-acquired property will give rise to an increased demand by creditors that the claims of other creditors be subordinated to the claim of the lender. A subordination agreement could very well be a pre-requisite for obtaining a loan in these situations.[33]

The use of subordination agreements is very common in an "insider transaction."[34] A typical case is that of a small businessman who has incorporated his business and holds a security interest in the assets of the corporation. Before a lending institution will make any loans to the corporation it will demand that the businessman subordinate his interests. The likelihood in this case is that the insolvency of the common debtor will also result in the insolvency of the businessman.[35]

Although no judicial decision has clarified the role of the subordination agreement under Article 9 of the Uniform Commercial Code, it is evident that perfecting any interest created by the subordination agreement by filing a financial statement as required by section 10.9-402 of the South Carolina Code, is not the practical answer. However, *Pioneer-Cafeteria Foods, Limited v. Mack*[36] indicates that the subordination agreement will not affect third parties unless they have notice of the agreement. Therefore, the best conclusion under the existing law is really no conclusion at all. The individual creditor must make a decision based on his need for notice to third parties versus a simple contractual priority. Under the existing law, filing a financial statement would vitiate the problem of notice to other creditors, although this may not be a practical solution to the problem.

B. *Sureties*

Another problem which arises under the application of Article 9 of the Code is whether or not the surety for the performance

32. FUNK, *supra* note 9, at 84.
33. 2 G. GILMORE, *supra* note 11, at 984.
34. COOGAN, *supra* note 14, at 2356.
35. *See* Pioneer-Cafeteria Foods, Ltd. v. Mack, 340 F.2d 719 (6th Cir. 1965).
36. 340 F.2d 719 (6th Cir. 1965).

of a contract or for payment of the labor or materialmen under a contract must file a financing statement in order to take priority over creditors of the surety's obligor. This problem also arises under the application of section 10.9-102 of the South Carolina Code. If the suretyship agreement is a security transaction then the requirements of Article 9 must be complied with in order that the surety have his desired priority.

The problem usually comes up in the following context.[37] The contractor enters into an agreement with an obligor to perform a certain contract. The contract requires a surety bond and calls for the obligor to make periodic payments to the contractor as the performance of the contract progresses. As part of the surety agreement the surety takes an assignment from the contractor for moneys due and moneys to become due under the contract to be paid to the surety if the surety must pay under his bond.

The contractor borrows money from a lending institution in order to begin performance on the contract. The lending institution also takes an assignment of moneys due and to become due on the contract. As part of the original contract, the obligor makes periodic payments directly to the lending institution where the payment is applied to the loan.

The problem arises when the contractor defaults and the surety must pay the materialmen and the laborers as well as have the job completed. The surety then seeks to recover the money he has paid from the bank or from the obligor depending on whether the obligor has made his payment or not. On United States Government contracts a further contest arises between the bank and the surety for the 10 percent retainage which is withheld from the contractor pending acceptance of the finished job.

There is no doubt that the lending institution must file in order to protect its priority in the assignment.[38] If the assignment of the contract right does not transfer a significant part of the overall rights under the contract, then filing will not be required.[39]

It would appear from a general reading of section 9-102 of the Code that the surety must likewise file to protect his assignment. In *United States v. Fleetwood & Company*,[40] the court, confronted with a conflict between the trustee in bankruptcy of

37. 2 G. GILMORE, *supra* note 11, at 947.
38. S.C. CODE ANN. § 10.9-102(2) (1966).
39. *Id.* § 10.9-302(1)(e).
40. 165 F. Supp. 723 (W.D. Pa. 1958).

a contractor and the surety who had to perform the contract when the contractor became insolvent, held that the surety must assume a position with the general creditors. The reason that the court did not favor the surety was because the surety did not file his suretyship agreement in conformity with Pennsylvania law. Pennsylvania had at that time adopted the Uniform Commercial Code.

However, in 1965, the Supreme Court of Pennsylvania, in *Jacobs v. Northeastern Corporation*,[41] held that sureties were not required to file under the Uniform Commercial Code in order to achieve a priority in the moneys due under a contract if the surety has had to pay. The court gave two important reasons for this result. First of all, a surety agreement is not designed to protect creditors. It is designed to insure the performance of the contract and, as such, protects the obligor of the contract. Therefore, the court felt that it was not a security agreement within the contemplation of the drafters of section 9-102 of the Uniform Commercial Code.[42]

Secondly, and perhaps more importantly, the court held that the surety's right to reimbursement was not a matter of contract right but was a right created by equity. The surety would be entitled to reimbursement under principles of subrogation even if the right was not in the contract. If the right to receive the funds due under the contract had arisen as a matter of subrogation, even if the right was also articulated in the contract, the Uniform Commercial Code would not require it to be perfected.[43] The logic of this conclusion is sound. If the right to subrogation was not spelled out in the contract, there would have been no requirement to file. Therefore, the mere fact that the contract spells out the right should not defeat the surety's subrogation rights.

The *Jacobs* case is the first state decision which has applied the Uniform Commercial Code to the surety problem. However, it is not the first case to apply the subrogation principle to award the surety a priority over the claims of other creditors of the contractor. In *Pearlman v. Reliance Corporation*,[44] the surety paid the materialmen and laborers the amount they were due. In so doing, the court held that the surety was subrogated to

41. 416 Pa. 417, 206 A.2d 49 (1965).
42. *Id.* at 427-28, 206 A.2d at 54.
43. *Id.* at 429, 206 A.2d at 55.
44. 371 U.S. 132 (1962).

their right to receive compensation for their work. By asserting their common law lien on the property, the surety was successful in claiming the amount due on the contract.

Since the *Jacobs* case will not be binding upon other state courts when they are confronted with the same question, it is important to point out the arguments both pro and con with respect to the question of whether the surety must file his agreement. The first argument is that when a surety enters a surety agreement he is assuming a contingent liability to complete the contract.[45] Since South Carolina Code section 10.9-102 specifically applies to a security interest created by contract — that is, the security that the contract will be performed, as well as the security that the surety gets by his rights to an assignment—it is felt that the surety agreement comes within the coverage of the Code.[46] The second argument is that this agreement demonstrates an obvious intention to give a security interest. Any transaction which is intended to create a security interest is clearly within the coverage of the Code.[47] However, in light of the *Jacobs* decision, these arguments are very weak.

One thing is fairly certain. If the surety does file his contract, then he will be entitled to the priority he receives by filing. However, his right to subrogation appears to be sufficient to protect his desire for priority.

C. *Lease of Personal Property with a Right of Purchase*

Section 10.1-201 (37) of the South Carolina Code states that unless a lease is intended as security, a reservation of title thereunder is not a "security interest." This section further states that whether a lease is intended to be security is to be determined by the facts of each case, but points out that the mere existence of an option to purchase the chattel does not of itself raise the presumption that the lease is intended as security even if no additional consideration is required. Accordingly, the absence of an option to purchase does not necessarily make the lease a true lease and not a security instrument.[48]

The problem in the area of leasing agreements is to determine when the particular leasing agreement will be creating "a secur-

45. 2 G. GILMORE, *supra* note 11, at 974.
46. S.C. CODE ANN. § 10.9-102(2) (1966).
47. *Id.* § 10.9-102(1)(a).
48. 1 G. GILMORE, *supra* note 11, at 338; S.C. CODE ANN. § 10.1-201 (37) (1966).

ity interest" which must be perfected under the provisions of Article 9 of the Code.[49] For example, if a piece of equipment has a useful life of three years, at the end of which the equipment has little or no remaining value, and the lessee agrees to pay the equivalent of the purchase price (less salvage value), this could be deemed an arrangement intended for security. This might be true even if there were no option to purchase the equipment and even if the lease provided that the lessor would retake the goods at the termination of the lease.[50] The argument in this situation is that the lessee was in reality purchasing the equipment but allowing the lessor to hold the title to secure the purchase price.

However, if the lease had provided that the lessee could terminate the arrangement at any time during the three year period, there is little doubt that the agreement would be a lease agreement not intended as security.[51] If the arrangement is a true lease, it is not subject to the provisions of Article 9 of the Code.[52]

Although the Code sets out no guidelines which may be used to determine whether or not the lease arrangement is intended as security, there are several tests which may be used to ascertain the status of a particular leasing agreement. First of all, if the parties themselves intend to create a security device, then it is apparent that the particular device is a security instrument. Secondly, if the rent on the equipment is to be applied to the purchase price in a disproportionate amount, then the courts may feel that this is in reality a conditional sale of the chattel with the title being retained in the seller (the lessor). In *United Rental Equipment Company v. Potts and Callahan Contracting Company*,[53] the lessee of an air compressor suffered a judgment against him and the compressor was sold at a sheriff's sale to satisfy the judgment. The lease provided that the lessee could purchase the compressor and 85 percent of the rental payments would be applied to the purchase price. The lessor sought to have the compressor returned to him from the purchaser at the sheriff's sale. The court, looking to the facts and circumstances of the case, decided that the lease agreement was an unrecorded security instrument and invalid as to subsequent purchasers or creditors

49. S.C. CODE ANN. § 10.9-102 (1966).
50. 1 G. GILMORE, *supra* note 11, at 339.
51. *Id.* at 339-40.
52. S.C. CODE ANN. § 10.9-102(2) (1966).
53. 231 Md. 552, 191 A.2d 570 (1963).

South Carolina Law Review, Vol. 19, Iss. 5 [1967], Art. 2

under Maryland law. The court stated that if the security interest is intended, then the least must be recorded. Thus under the Uniform Commercial Code, recordation of this type of lease would be necessary. The key fact in this case was that the lessee could apply 85 percent of the rental payments to the purchase price.

A third test which may be used to ascertain whether or not the lease agreement is a "security agreement" or a *bona fide* lease agreement is to look at the agreement itself. In the case of *Alban Tractor Company v. State Tax Commission*,[54] the court found that the "lessor" of the chattel was in reality the holder of a "security interest" for the following reasons: (1) a commission had been paid to a salesman who had handled the transaction; (2) the lessor had reported the transaction as a sale for purposes of income taxation; (3) no depreciation was taken on the goods by the lessor; (4) the lease was recorded; (5) the rent on the machinery was disproportionate to the useful life of the equipment and to its value. In this case the Maryland Tax Commission was seeking to tax the lessor as the owner of the machinery. The intention of the parties was found to be a security interest created rather than a lease agreement.

Whether or not a leasing agreement comes within the provisions of Article 9 is more a question of fact than law. However, the above considerations will enable the practicing attorney to be aware of the problem and take steps to protect the agreement if it is intended as security and take steps to assure that no security agreement is created when none is intended.

D. *Conclusion*

If a problem arises with regard to any of the three areas previously covered, extra care must be used to ascertain whether or not the provisions of Article 9 of the Code will be applicable. The important consideration is the intention of the parties. This is the controlling factor under the Code.

III. Partial Coverage Under Article 9

There are several other areas which are only partially covered by Article 9. One of the areas deals with the effect of non-consensual liens versus the secured party. This area is of particular importance to the practicing attorney since it specifically re-

54. 219 Md. 593, 150 A.2d 456 (1959).

verses the priority of certain statutory and common law liens when they are in conflict with a recorded security instrument. Other areas discussed below are National Filing Systems and South Carolina Certificate of Title laws.

A. *Non-consensual Liens*[55]

South Carolina Code Section 10.9-310 provides:

> When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.[56]

The purpose of this section is to give priority to liens created by statute or by rules of law where the lien arises from work which enhances or preserves the value of the collateral although a security interest in the collateral has been perfected.[57] However, the drafters of the Code left the priority question of non-consensual liens versus the secured party as a matter of local legislative policy by making an exception to section 9-310. If the lien is created by statute and the statute expressly provides that the lien will not be superior to the security interest, then the non-consensual lien will not take priority.[58]

Prior to the adoption of the Uniform Commercial Code in South Carolina, the policy was to favor the perfected security interest or the recorded chattel mortgage over non-consensual liens unless the statute expressly gave the lien a priority.[59] The South Carolina Supreme Court recognized that statutes creating non-consensual liens only provided a method of enforcing the common law lien. Unless the statute expressly gave the common law lien a priority, the perfected security interest took priority.[60]

55. Non-consensual liens may be defined as the interest in particular goods which arise by operation of law and without the consent of the "owner" of the goods.

56. S.C. CODE ANN. § 10.9-310 (1966).

57. *Id.* § 10.9-310; UNIFORM COMMERCIAL CODE § 9-310, Comments 1.

58. S.C. CODE ANN. § 10.9-310 (1966).

59. R. H. Nesbitt Auto Co. v. Whitlock, 113 S.C. 519, 101 S.E. 822 (1920).

60. R. H. Nesbitt Auto Co. v. Whitlock, 113 S.C. 519, 101 S.E. 822 (1920). *Compare,* Layton v. Flowers, 243 S.C. 421, 134 S.E.2d 247 (1964).

There are several strong arguments for the Code policy of favoring the lien over the security interest within the limits of section 10.9-310 of the South Carolina Code. As a matter of simple economics, it is good policy to encourage the repair of property. Not only does this enhance the value of the collateral of the loan, it also encourages the owner of the property to get the maximum utility out of his property. Encouraging repairs also creates an entire scope of job opportunities in the economy. If the repairman is assured of payment by the reason of having a lien on the goods he repairs, and has the additional advantage of having a priority of payment, this economic policy of encouraging repairs will be advanced.

One theory for giving the repairman or the person who "furnishes services or materials with respect to goods" a priority is the waiver or consent theory.[61] This concept is based on a legal fiction which supposes that the secured party impliedly consents to repairs which enhance the value of the collateral.[62] This theory has been strengthened by such language in the security agreements as "the mortgagor agrees to keep the collateral in good repair" as a condition of the agreement.[63] The agency theory is basically the same. Several courts have found that the mortgagor was the "agent" of the mortgagee when authorizing repairs.[64]

The application of section 10.9-310 is not so simple as first meets the eye. In order to ascertain the priority of a particular statutory or common law lien versus a particular security interest several tests should be utilized.

First of all, the goods must be in the *possession* of the person who has furnished the goods and services.[65] This requirement of a possessory lien is perhaps the greatest limitation to the scope of section 9-310. The unanswered question in this area is whether or not an interpretation of this section will result in a lienor out of possession being subordinate to the secured party, whereas the identical lienor in possession would have priority.[66] Under pre-code law most service or materials liens were possessory. The lien was lost by a voluntary parting of possession of the

61. 2 G. GILMORE, *supra* note 11, at 879.
62. *Id.*, *supra* note 11, at 879 n.5.
63. *Id.*, *supra* note 11, at 879.
64. *Id.*
65. S.C. CODE ANN. § 10.9-310 (1966).
66. 2 G. GILMORE, *supra* note 11, at 888.

chattel to which the lien attached.[67] If, however, the owner of the goods takes possession of his chattel without the knowledge or consent of the artisan who has the lien, the artisan does not lose his lien. Furthermore, the artisan is entitled to have the chattel returned to his possession.[68] There is no reason to doubt that these rules of possession will apply under the Code.

An even more difficult question arises where the lienor may protect his lien by recordation or filing. If the lienor files his lien while in possession of the chattel and then surrenders possession, he will no longer be a lienor in possession.[69] If surrendering possession reverses the priorities (thus subordinating the lien to the perfected security interest), the lienor may find himself the preferred party one day and the subordinated party the next day.[70]

There is a simple explanation for the possessory requirement. The Code's policy of disfavoring the secret or hidden lien on property is enhanced by the requirement that the artisan have possession of the chattel. Once the chattel is returned to its "owner" a purchaser of the chattel would have no reason to believe that an artisan's lien was encumbering the property.

The following sections of the South Carolina Code do create liens in favor of the person providing materials or services where the person is likewise in *possession* of the chattel. All of these sections are silent as to priority, therefore, section 10.9-310 of the Code will accord them priority. South Carolina Code section 45-554.1 gives a lien to a stable or kennel keeper for the cost of care on the animal that has been kept;[71] section 45-555 gives a lien to persons who perform work on textiles for the charges for the labor on such textiles;[72] section 45-557 gives a lien to laundries on clothes left for any cleaning, repair, etc., for the charges due on such work;[73] and section 45-550 grants a lien to garagemen and mechanics for repair and storage charges on goods.[74]

67. Johnson v. Parker, 4 S.C. 1 (1817).

68. Bouknight v. Headden, 188 S.C. 300, 199 S.E.2d 315 (1938).

69. While none of the lien statutes found in Article 45 of the Code of Laws of South Carolina, expressly provide for recording the lien created therein, S.C. CODE ANN. § 60-101 (1962) indicates that recording must be accomplished to protect the lienor's priority against subsequent purchasers or creditors. *Contra,* Layton v. Flowers, 243 S.C. 421, 134 S.E.2d 247 (1964).

70. 2 G. GILMORE, *supra* note 11, at 888.

71. S.C. CODE ANN. § 45-554.1 (1962).

72. *Id.* § 45-555.

73. *Id.* § 45-557.

74. *Id.* § 45-550.

The following sections of the South Carolina Code provide for subordination or priority and would continue in effect because of the language of section 10.9-310 "unless the lien is statutory and the statute expressly provides otherwise".[75] Section 45-301 grants a lien to laborers, sub-contractors, and materialmen on the money received by the building contractor for a specific job;[76] section 45-351 gives a lien on ships and materials used in the construction and repair of ships to the laborers and materialmen involved in the construction or repair;[77] section 45-505 gives a lien on chattels supplied for agricultural uses;[78] and section 45-451 gives miners and employees of manufacturing concerns a lien on the output or production for unpaid wages or salaries.[79]

Once it has been ascertained whether or not a particular lien meets the possessory lien test, then the second test must be applied. If the statute which creates the lien has expressly provided for priority or for subordination, then the lien takes priority or is subordinated regardless of case decisions which would make the lien subordinate to a perfected security interest.[80]

This is a very important consideration for the practicing attorney for it is in this area of the law that section 10.9-310 reverses the existing South Carolina law. Suppose that on June 1, 1966, Buyer purchases an automobile from Seller Auto Dealer. Buyer makes a substantial down payment on the purchase and gives Seller a security instrument for the balance. Seller transfers the instrument to First Bank on June 3, 1966, and First Bank perfects its security interest in the instrument. On October 10, 1966, Buyer takes the automobile to Repairman to have work done on the transmission. The repair bill is $200. Buyer then becomes insolvent and cannot pay First Bank or Repairman.

Under the doctrine announced in *R. H. Nesbitt Auto Company v. Whitlock*,[81] Repairman, even though he has a possessory repairman's lien created by common law and recognized by statute, would be subordinate to the perfected security interest of First

75. *Id.* § 10.9-310 (1966).
76. *Id.* § 45-301.
77. *Id.* § 45-351.
78. *Id.* § 45-505.
79. *Id.* § 45-451.
80. S.C. CODE ANN. § 10.9-310 (1966).
81. 113 S.C. 519, 101 S.E. 822 (1920).

Bank. The court in *Nesbitt* held that the statute recognizing the lien only provided for a method of enforcing the common law lien and did not give the repairman priority since the statute was silent as to priority.[82]

Under section 10.9-310 of the South Carolina Code, if the statute is silent as to priority, then the lienor will prevail. This clearly overrules the *Nesbitt* case.

The third test which must be applied to ascertain the applicability of section 9-310 is that the lienor must have furnished the services or materials in the "ordinary course of business."[83] This requirement should be equated as being "tantamount to a requirement of good faith."[84] The notion that a good faith transaction is essential to conduct being in the "ordinary course of business" is found in section 9-203 which states in essence that "every contract or duty within this act imposes an obligation of good faith in its performance or enforcement."[85] The good faith or "ordinary course of business" requirement implies a lesser standard than fraud and could give the court an opportunity to deny or reduce the priority of the lien if the court feels that the lienor may have been less than "honest in fact"[86] in the transaction.[87]

As was stated earlier, non-consensual liens are only partially within the scope of Article 9 coverage. The application of the repairman's lien or the artisan's lien illustrates the coverage aspect of Article 9. One of the best illustrations of the non-coverage aspect of the Article is the application of the landlord's lien versus the secured party. Code section 9-104 states that "this article does not apply . . . (b) to a landlord's lien."[88] Therefore, the rule of South Carolina Code section 45-155 will still be applicable. This section gives the mortgagee of the personal property located on the premises superior rights. The landlord has an option of paying off the mortgage and then having the amount apply as part of the distraint. This section is not affected by section 9-310.

82. *Id.* at 521, 101 S.E. at 822.
83. S.C. CODE ANN. § 10.9-310 (1962).
84. 2 G. GILMORE, *supra* note 11, at 888.
85. S.C. CODE ANN. § 10.9-203 (1966).
86. *Id.* § 10.1-201(19).
87. 2 G. GILMORE, *supra* note 11, at 888.
88. S.C. CODE ANN. § 10.9-104 (1966).

Perhaps the most important question raised by section 9-310 is its effect on South Carolina Code section 45-551. This section creates a lien on a motor vehicle for damages resulting from the negligent operation of the motor vehicle. This section will not be affected by section 9-310 nor will the cases which have extended the statutory priority of this lien over *bona fide* purchasers of the vehicle without notice of the lien.

B. *National Filing Systems*

There are many commercial transactions which are within the scope of Article 9 of the Code with respect to the creation of a security interest, priority in the proceeds after sale of the collateral, priority on default of the debt, and the other rules governing default and sale of the collateral. However, Article 9 does not require that its filing provisions be complied with in order to perfect the security interest created.

South Carolina Code section 10.9-302(3)(a) provides that the filing provisions of Article 9 do not apply to "a security interest in property subject to a statute of the United States which provides for a national registration or filing of all security interests in such property."[89] Therefore, if particular property is subject to statutes of the United States, the secured party is well advised to consult the individual statutes to ascertain if there exists a national filing system. Illustrative of this requirement are the federal statutes requiring national filing of assignments of patents and copyrights.[90] Security interests in aircrafts, railroads, and ships all require national filing.

An application of this provision can create problems as is illustrated by the Assignment of Claims Act of 1940.[91] This act requires that any assignment of claims must be reported to the contracting and disbursing officers of the United States before the United States is bound by the assignment of claims against it. This act did not establish a filing system *per se* although it can be argued that the requirement that notice be given the United States implies a filing with the United States. The official comments to section 9-302(3)(a) of the Uniform Com-

89. *Id.* § 10.9-302(3)(a).
90. 17 U.S.C. §§ 28, 30 (1964).
91. 31 U.S.C. § 203 (1964).

mercial Code advise that the assignee of a claim against the United States must file under Article 9 in order to be protected.[92]

C. *Certificate of Title Laws*

South Carolina Code section 10.9-302(3)(b) provides:

> The filing provisions of this Article do not apply to a security interest in property subject to a statute of this state which provides for central filing of, or which requires indication on a certificate of title of, such security interests in such property, including, but not limited to the filing provisions of Section 60-252, Code of Laws of South Carolina, 1962, for a security interest in property of any description or any interest therein created by mortgage made by a railroad company as defined in Section 58-852 Code of Laws of South Carolina, 1962.[93]

This section subordinates the filing requirements of Article 9 to the South Carolina Certificate of Title Laws if notation is required to be placed on the certificate of title and if the certificate of title is the exclusive method of perfecting the security interest. It must be remembered that Article 9 does extend to all other aspects of the transaction.

92. S.C. CODE ANN. § 10.9-302 (1962); UNIFORM COMMERCIAL CODE § 9-302, Comment 8.

93. *Id.* § 10.9-302(3)(b).